

**Outreach Initiatives Need to Ensure Taxpayers
Receive the Benefit of the Child Tax and
Additional Child Tax Credits**

September 2002

Reference Number: 2002-40-203

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

September 27, 2002

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

Michael R. Phillips
FROM: Michael R. Phillips
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report - Outreach Initiatives Need to Ensure
Taxpayers Receive the Benefit of the Child Tax and Additional
Child Tax Credits (Audit # 200240057)

This report presents the results of our review to assess the progress made by the Internal Revenue Service (IRS) in its initiative to notify individual taxpayers who may be eligible for unclaimed Child Tax Credits (CTC) and Additional Child Tax Credits (ACTC).

In the IRS Restructuring and Reform Act of 1998 (RRA 98),¹ the Congress directed the IRS to review and restate its mission to increase its emphasis on serving the public and meeting taxpayer needs. The IRS responded by changing its mission statement to emphasize the importance of customer service and developing a strategy to better understand and resolve taxpayer problems while also reducing taxpayer burden. As a positive step toward carrying out this strategy, the IRS proposed an initiative for 2002 to identify and contact taxpayers who appeared eligible for, but failed to claim, the CTC and/or ACTC on their 2001 Individual Income Tax Returns. This initiative would have required the IRS to develop a specific computer program to ensure taxpayers received an advisory notice of their potential eligibility. It was proposed as an alternative approach to the IRS' original programming request that was not completed because of the programming demands required for legislative tax laws and changes.

The IRS' proactive initiative to implement an alternative approach was recently interrupted when the IRS concluded that it would also be unable to complete the initiative as a fallback approach because of legal and budgetary concerns and the programming complexities required. The IRS currently has no alternative plan to assist

¹ Pub. L. No. 105-206, 112 Stat 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

the large number of primarily low-income taxpayers² who may be affected by this decision.

Since 1999, the IRS has been aware that some taxpayers who appear qualified were not claiming the CTC. In a prior Treasury Inspector General for Tax Administration (TIGTA) report,³ the IRS stated that it would communicate to taxpayers through future outreach programs. Although the IRS has initiated several actions to educate taxpayers through publications and community outreach programs designed to publicize the tax benefits available from the provisions of the CTC and/or ACTC, many taxpayers are not claiming the credit.

During the processing of individual tax returns between January 1, 2002, and May 31, 2002, we identified 611,560 returns on which taxpayers did not claim potential tax credits totaling \$238 million in ACTC⁴ for Tax Year 2001. Eighty-seven percent of these taxpayers qualified under the new provisions for the ACTC in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA),⁵ with 74 percent reporting earned income of less than \$25,000 per year. The IRS' decision to cancel the 2002 initiative will prevent the issuance of advisory notices to these 611,560 taxpayers.

In April 2002, we issued a memorandum⁶ to the Director, Submission Processing, recommending that the IRS consider modifying its proposed initiative. This modification suggested accelerating the issuance of notices by using the TIGTA's listing of affected returns as a means to quickly notify taxpayers of their potential ACTC eligibility.

Currently, the IRS assigns the highest priority to the required computer programming necessary to implement legislative tax laws and changes each year. To ensure a better chance of success for future outreach initiatives, we also recommended that the IRS reevaluate placing a higher priority on the necessary discretionary computer programming based on the related tax laws that these initiatives are intended to support.

Management's Response to Memorandum #1: The Director, Submission Processing, replied to our recommendation to modify the IRS' proposed initiative by stating that an IRS organizational decision had been made not to issue advisory notices to taxpayers who had not claimed tax credits for the CTC and/or ACTC on their original tax returns. The primary reason for this decision was an IRS concern that it had no legal requirement to notify taxpayers of unclaimed or under-claimed tax credits and to do so would set a significant precedent, causing potentially adverse consequences for the

² For the purpose of this report, low-income taxpayers are considered to have earned income of less than \$25,000, regardless of family size.

³ *The Internal Revenue Service Could Enhance the Process for Implementing New Tax Legislation* (Reference Number 2000-40-029, dated March 2000).

⁴ The TIGTA's computer extract identified returns claiming the CTC and then analyzed the return data for the potential eligibility for the ACTC when it was not claimed. The extract did not identify returns of taxpayers who did not claim the CTC but may have been eligible.

⁵ Pub. L. No. 107-16, 115 Stat. 38.

⁶ See Appendix V, Memorandum dated April 30, 2002.

IRS. Other reasons included the impact on resources and a possible negative impact on the computer programming resources required to implement legislative changes for the next filing season.

As an alternative to our recommendation, the IRS proposed exploring ways to improve taxpayer awareness, such as requesting assistance through the Stakeholder Partnerships, Education, and Communication organization. The IRS' complete response to the Memorandum is included as Appendix VI.

Office of Audit Comment: We agree that improving taxpayer awareness is something the IRS should always strive for in the future. However, an increased awareness effort may not help the primarily low-income taxpayers currently affected by the condition identified since they would be required to file an amended tax return if eligible. The amended return process has been noted as a significant source of taxpayer burden according to the Taxpayer Advocate Service's 2001 report to the Congress, which shows amended returns ranking second on its list of taxpayer problems.

Secondly, the IRS states as the primary basis for its decision that it is not legally obligated to issue notices to taxpayers that either did not claim or under-claimed tax credits on their tax returns. Although taxpayers are responsible for filing complete and accurate returns, the IRS proactively planned to notify taxpayers of their potential credit eligibility in its proposed initiative. This planned action is similar to the one currently used to notify taxpayers of potential Earned Income Tax Credit eligibility.

Providing quality service for many organizations, both public and private, may at times mean doing more than just what is required by law or procedure. For example, the RRA 98 mandated that the IRS change its mission and increase its emphasis on serving the public and taxpayer needs. We believe this includes ensuring that taxpayers not only comply with existing tax laws but also receive adequate assistance when tax laws are changed or added. Outreach initiatives help ensure that taxpayers, particularly those with low income, receive the tax benefits they are entitled to and that the Congress intended. They also play an important part in the overall quality service the IRS provides.

Management's Response to the Draft Report: While IRS management did not agree with Recommendation 1, they plan to work with the TIGTA in a cooperative effort to initiate a viable alternative to inform the 611,560 taxpayers identified of their potential eligibility relating to the \$238 million in unclaimed ACTC. The IRS will mail special advisory information to taxpayers identified as potentially eligible for the ACTC and provide them tax forms and instructions on how to claim the credit if eligible.

The IRS also does not agree with Recommendation 2. No corrective action is planned on this recommendation due to priority demands associated with implementing new tax law changes and other critical programming needs. The IRS stated that, "As an organization, we must make difficult decisions based on priorities to implement changes to the tax law and to support the Modernization effort." Management's complete response to the draft report is included as Appendix VII.

Office of Audit Comment: While we believe Recommendation 2 is worthy of further consideration, we recognize the limitations expressed by the IRS. We do not intend to elevate our disagreement concerning this matter to the Department of the Treasury for resolution and believe the IRS will continue working to overcome such limitations in the future.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 927-0597.

**Outreach Initiatives Need to Ensure Taxpayers Receive
the Benefit of the Child Tax and Additional Child Tax Credits**

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Outreach Initiatives Need to Ensure Taxpayers Receive the Benefit of the Child Tax and Additional Child Tax Credits

Background

The Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98)¹ made wide-ranging changes relating to the operations of the Internal Revenue Service (IRS). In the RRA 98, the Congress directed the IRS to review and restate its mission to increase its emphasis on serving the public and meeting taxpayer needs. The IRS revised its mission statement from one that focused on collecting the proper amount of tax to one that emphasized providing top quality service to taxpayers.

To assist in achieving its new mission, the IRS developed a strategic plan that includes strategic goals, guiding principles, and major strategies to guide the IRS toward its new mission emphasis. Some important points outlined by the new strategic plan include providing service to each taxpayer, understanding and solving problems from the customer's point of view, meeting taxpayer needs, and reducing taxpayer burden. These actions are intended to better serve taxpayers in the future; however, for many, the degree of success will depend on and be measured by how well the IRS implements the intent based within this strategy.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)² included several new provisions for Tax Year (TY) 2001 that provide tax relief to low-income families.³ These provisions modified the existing Child Tax Credit (CTC), added a new 10 percent tax rate bracket, and created a Rate Reduction Credit (RRC). The CTC was established by the Tax Relief Act of 1997 (TRA 97)⁴ and was the first tax credit based solely on a family's number of children. The TRA 97 provided a \$500 credit for every child in a family under the age of 17. The Congress

¹ Pub. L. No. 105-206, 112 Stat 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

² Pub. L. No. 107-16, 115 Stat. 38.

³ For the purpose of this report, low-income taxpayers are considered to have earned income of less than \$25,000, regardless of family size.

⁴ Pub. L. No. 105-34, 111 Stat. 788 (codified as amended in scattered sections of 5 U.S.C., 19 U.S.C., 26 U.S.C., 29 U.S.C., 31 U.S.C., 42 U.S.C., and 46 U.S.C. app).

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believed this credit would help reduce the tax burden for taxpayers, recognize the financial responsibilities of raising dependent children, and promote family values.

In Congressional testimony prior to the passage of the EGTRRA, concern was raised that the original proposal to increase the amount of the CTC over the next 10 years to \$1000 per child would not benefit an estimated 12.2 million low- and moderate-income families with children. To address this concern, the Congress modified the CTC provisions and made the credit refundable for taxpayers with any number of children, rather than limiting it to families with three or more children, as under the TRA 97.

All taxpayers can now receive a refund of their CTC when they have no tax liability. However, the refund is limited to 10 percent of a taxpayer's earned income over \$10,000. This percentage will be increased to 15 percent for TYs 2005 and beyond. The refundable CTC is commonly known as the Additional Child Tax Credit (ACTC).

We performed this review from April through June 2002 with IRS executives and personnel in the IRS' Submission Processing Headquarters offices in Cincinnati, Ohio, and New Carrollton, Maryland. Audit fieldwork was performed at the IRS Submission Processing Campus located in Austin, Texas.

The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

Outreach Plans to Notify 611,560 Taxpayers of Potential Tax Credits Totaling \$238 Million Have Been Cancelled

Since 1999, the IRS has been aware that some taxpayers who appear qualified were not claiming the CTC. In a prior Treasury Inspector General for Tax Administration (TIGTA) report,⁵ the IRS acknowledged this and indicated that it would continue efforts to effectively communicate with taxpayers regarding this credit through outreach

⁵ *The Internal Revenue Service Could Enhance the Process for Implementing New Tax Legislation* (Reference Number 2000-40-029, dated March 2000).

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programs. Although the IRS has initiated several actions in recent years to educate taxpayers through publications and community outreach programs designed to publicize the tax benefits available from the provisions of the CTC and/or ACTC, many taxpayers are not claiming the credit.

Prior to 2002, the IRS accurately predicted that some taxpayers would fail to claim the ACTC under the new tax law provisions of the EGTRRA. During the period of January 1, 2002, through May 31, 2002, our computer analysis identified approximately 1.6 million TY 2001 returns⁶ where taxpayers claimed the ACTC. However, our analysis also identified an additional 611,560 returns on which taxpayers appeared eligible for, but did not claim, the ACTC totaling \$238 million.

To address this situation and to carry out the guiding principles in the IRS' strategic plan, the IRS originally planned to conduct an outreach initiative in 2002 that would enable it to contact taxpayers who appeared eligible for, but did not to claim, tax credit for the CTC and/or ACTC on their Individual Income Tax Returns. To accomplish this initiative would require that the IRS develop and program an automated computer process to identify potentially eligible taxpayers as their tax returns were being processed each year.

This process is similar to the service the IRS currently provides to taxpayers for the Earned Income Tax Credit (EITC). Using information taken each year from individual tax returns, an automated process sends notices to taxpayers stating that they may be eligible for the EITC and requests the taxpayer to respond with additional information needed for the IRS to make an eligibility determination. Returning the notice with the additional information serves as a claim for the credit, and the taxpayer can receive the EITC without having to file an amended return.

However, because of the high priority assigned to the programming demands required for the new legislative tax laws and changes in 2002, the IRS' original initiative could

⁶ This analysis identified returns that included the Additional Child Tax Credit (Form 8812).

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not be programmed. Using an alternative approach, the IRS proposed an initiative requiring a computer program that would be used to identify eligible taxpayers at a later date after their 2001 tax return had been processed, rather than during filing season processing.

Unfortunately, the IRS later concluded that it would also be unable to implement this alternative approach because of concerns that the IRS had no legal requirement to notify taxpayers of unclaimed or under-claimed tax credits and to do so would establish a significant precedent. The IRS believed that setting such a precedent could obligate the IRS to contact other taxpayers who may be eligible for other various types of tax credits. Additional reasons for canceling the initiative included the impact on available resources and a possible negative impact on the computer programming resources required to implement legislative changes for the 2003 Filing Season.⁷

The IRS currently has no alternative plan to assist the large number of primarily low-income taxpayers that may be affected by this decision in the future or to effectively issue advisory notices on the 611,560 returns of taxpayers who appear eligible for, but did not claim, the CTC and/or ACTC for TY 2001. These taxpayers were identified in the following two groups:

- ***Taxpayers who appeared eligible for, but did not claim, the credit on their originally filed 2001 Individual Income Tax Returns.*** On 478,888 returns, the taxpayers appeared to be eligible to claim the ACTC but simply failed to do so. The potential unclaimed ACTC on these returns totaled approximately \$212.3 million.
- ***Taxpayers who did not receive the credit after becoming eligible when their returns were corrected for errors during IRS processing.*** On 132,672 returns, the taxpayers appeared to be ineligible for the ACTC on their returns as originally filed. However, after these returns were corrected for errors during IRS processing, the correction resulted in the taxpayers also becoming

⁷ See Appendix VI.

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eligible for the ACTC. Although alerted to this condition by processing function employees, the IRS made a decision not to apply the credit during the error correction process based on the planned 2002 outreach initiative. Unapplied ACTC on these returns totaled approximately \$25.7 million.⁸

For the 611,560 returns in these 2 taxpayer groups, 87 percent (530,905) qualified for the ACTC under the new tax law provisions of the EGTRRA and 74 percent (451,646) reported earned income of less than \$25,000 per year.

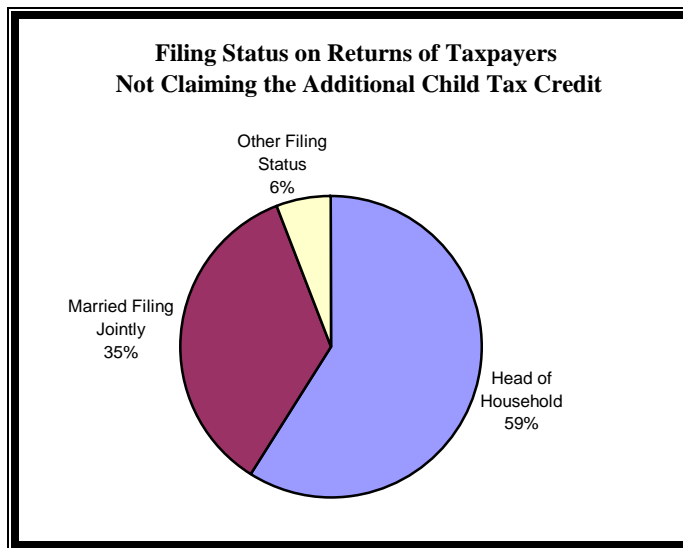
Income Ranges of Taxpayers Not Claiming the Additional Child Tax Credit		
Earned Income Ranges	Number of Returns	Percentage
\$10,000 to \$14,999	156,615	25.61%
\$15,000 to \$19,999	175,826	28.75%
\$20,000 to \$24,999	119,205	19.49%
\$25,000 to \$29,999	70,851	11.59%
Over \$30,000	89,063	14.56%
Total	611,560	100.00%
Returns processed between January 1 and May 31, 2002.		

Source: Analysis of the IRS Individual Return Transaction File.

In addition, the potential refund of unclaimed ACTC on these 611,560 returns averages \$389.38, with the 2 largest return filing groups being unmarried head of household (59 percent) and married filing jointly (35 percent).

⁸Although the 2002 Filing Season Was Completed Timely, Customer Service Can Be Improved During Error Processing (Reference Number 2002-40-200, dated September 2002).

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Source: Analysis of the IRS Individual Return Transaction File.

As the IRS moves forward with its modernization efforts, priority must be placed on ways to integrate quality taxpayer service into all aspects of IRS processes. Computer programming should include an effective means for reducing taxpayer burden as well as efficiently processing tax information. This will enable the IRS to serve taxpayers by reducing taxpayer burden and providing taxpayers with the legislated tax benefits that they may be entitled to. Such action is needed for the IRS to change from an organization that concentrates on collecting the proper amount of tax to one that also emphasizes providing top quality service to taxpayers, as stated in the IRS mission statement and required by the RRA 98 legislation. This is especially true for low-income taxpayers who may be unable to afford the services of a tax preparer to help ensure they receive appropriate tax benefits in the future.

Recommendations

1. The Commissioner, Wage and Investment (W&I), should consider modifying its 2002 outreach initiative to taxpayers by accelerating the issuance of advisory notices to ensure that taxpayers receive the tax benefit of the ACTC for TY 2001. Please see Appendix V for additional details in the TIGTA memorandum issued April 30, 2002.

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Management's Response to Memorandum #1: The Director, Submission Processing, replied to our recommendation to modify the IRS' proposed initiative by stating that an organizational decision had been made not to issue advisory notices to taxpayers who had not claimed tax credits for the CTC and/or ACTC on their original tax returns. The primary reason for this decision was an IRS concern that it had no legal requirement to notify taxpayers of unclaimed or under-claimed tax credits and to do so would set a significant precedent, causing potentially adverse consequences for the IRS. Other reasons included the impact on resources estimated at \$14.4 million⁹ to print, mail, and process the notices and a possible negative impact on the computer programming resources required to implement legislative changes for the next filing season.

As an alternative to our recommendation, the IRS proposed exploring ways to improve taxpayer awareness such as requesting assistance through the Stakeholder Partnerships, Education, and Communication organization.

Office of Audit Comment: We agree that improving taxpayer awareness is something the IRS should always strive for in the future. However, an increased awareness effort may not help the primarily low-income taxpayers currently affected by the condition identified since they would be required to file an amended tax return if eligible. The amended return process has been noted as a significant source of taxpayer burden according to the Taxpayer Advocate Service's 2001 report to the Congress, which shows amended returns ranking second on its list of taxpayer problems.

Secondly, the IRS states as the primary basis for its decision that it is not legally obligated to issue notices to taxpayers that either did not claim or under-claimed tax credits on their tax returns. Although taxpayers are responsible for filing complete and accurate returns, the IRS proactively planned to notify taxpayers of their potential credit eligibility in its proposed initiative. This planned action is

⁹ The basis used to substantiate the IRS' estimated \$14.4 million cost was not evaluated in this review.

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similar to the one currently used to notify taxpayers of their potential eligibility for the EITC.

Providing quality service for many organizations, both public and private, may at times mean doing more than just what is required by law or procedure. For example, the RRA 98 mandated that the IRS change its mission and increase its emphasis on serving the public and taxpayer needs. We believe this includes ensuring that taxpayers not only comply with existing tax laws but also receive adequate assistance when tax laws are changed or added. Outreach initiatives help ensure that taxpayers, particularly those with low income, receive the tax benefits they are entitled to and that the Congress intended. They also play an important part in the overall quality service the IRS provides.

Management's Response to the Draft Report: IRS management stated, "Although we cannot agree with this recommendation, through our cooperative efforts we will initiate a viable alternative to inform taxpayers of their potential eligibility. As a result of TIGTA's willingness to provide taxpayer address information, we will mail special advisory information to taxpayers identified as potentially eligible for the ACTC and provide them tax forms and instructions on how to claim the credit if eligible."

2. The Commissioner, W&I, should reevaluate placing a higher priority on the discretionary computer programming necessary to implement future outreach initiatives based on the related tax laws that these initiatives are intended to support.

Management's Response: IRS management stated, "Due to high priority demands associated with implementing new tax law changes and other critical programming needs, the IRS was not able to implement the Additional Child Tax Credit initiative." Management also stated, "As an organization, we must make difficult decisions based on priorities to implement changes to the tax law and to support the Modernization effort."

Office of Audit Comment: While we believe our recommendation is worthy of further consideration, we

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recognize the limitations expressed by the IRS. We do not intend to elevate our disagreement concerning this matter to the Department of the Treasury for resolution and believe the IRS will continue working to overcome such limitations in the future.

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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to assess the progress made by the Internal Revenue Service (IRS) in its plans to notify individual taxpayers who may be eligible for unclaimed Child Tax Credits (CTC) and Additional Child Tax Credits (ACTC). This review focused on the IRS' plans in 2002 to notify taxpayers who appeared eligible to claim the ACTC on their 2001 Individual Income Tax Return. To accomplish our objective, we:

- I. Assessed the status of the IRS' plans to notify taxpayers who appear eligible for the CTC and ACTC.
 - A. Interviewed IRS program management and determined their plans and the status of the ACTC outreach initiative.
 - B. Reviewed Requests for Information Services and determined their status.
- II. Identified taxpayers who had not claimed the ACTC on their 2001 Individual Income Tax Returns that appeared eligible.
 - A. Requested support from the Treasury Inspector General for Tax Administration Electronic Data Processing Group with computer-identifying returns of taxpayers processed to the Individual Master File (IMF)¹ who appeared eligible for the ACTC.
 - B. Computer-analyzed the IRS' Return Transaction File (RTF) Tax Year 2001² records from January 1, 2002, through May 31, 2002, and developed specific criteria to select individual return data for taxpayers who appeared eligible for the ACTC. The selected data were analyzed and updated each week after posting to the IMF. The analysis resulted in 611,560 returns being identified for taxpayers who appear entitled to, but did not claim, \$238 million in ACTC.
 - C. Computer-analyzed the return data in II.B above to identify the characteristics of the taxpayers eligible for the ACTC. The analysis determined that 451,646 (74 percent) of the returns reported earned income of less than \$25,000 per year. In addition, the 2 largest filing groups with unclaimed credit were unmarried head of household 359,516 (59 percent) and married filing jointly 216,158 (35 percent). On 530,905 returns (87 percent), the taxpayers qualified for the ACTC under the new tax law provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001.³

¹ The IMF is the IRS database that maintains transactions or records of individual tax accounts.

² The RTF contains tax return information transcribed during processing and includes other information such as math calculations.

³ Pub. L. No. 107-16, 115 Stat. 38.

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Appendix II

Major Contributors to This Report

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Steven Vandigriff, Senior Auditor

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Glory Jampetero, Auditor

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Appendix III

Report Distribution List

Commissioner N:C
Deputy Commissioner, Wage and Investment Division W
Director, Customer Account Services W:CAS
Director, Submission Processing W:CAS:SP
Director, Strategy and Finance W:S
Chief Counsel CC
National Taxpayer Advocate TA
Director, Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O
Office of Management Controls N:CFO:F:M
Audit Liaison: Program/Process Assistant Coordinator, Wage and Investment Division W:HR

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Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our report will have on tax administration. This impact will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:

- Taxpayer Entitlements – Potential; 478,888 returns on which taxpayers appeared eligible for, but did not claim, \$212.3 million in Additional Child Tax Credit (ACTC).

These 478,888 returns represent part of a total population of 611,560 returns that the Treasury Inspector General Tax Administration (TIGTA) has identified as potentially eligible to receive unclaimed ACTC totaling \$238 million. The remaining 132,672 returns will also not be contacted, based on an Internal Revenue Service (IRS) decision, and the additional outcome measure showing \$25.7 million of unapplied ACTC will be reported in a separate TIGTA report.¹

Methodology Used to Measure the Reported Benefit:

The TIGTA conducted a computer analysis during the 2002 Filing Season to determine if taxpayers were receiving the full benefits of new tax law provisions. We acquired the current (Tax Year 2001) IRS' Individual Return Transaction File (RTF) records and developed specific criteria to select certain individual return data for taxpayers affected by the new tax laws. The selected data were further analyzed and updated generally once each week after posting to the Individual Master File (IMF).² The 478,888 returns identified represent taxpayers who appeared entitled to, but did not claim, \$212.3 million of the ACTC based on our analysis of all 2001 Individual Income Tax Returns that were added to the RTF between January 1, 2002, and May 31, 2002.

To identify and quantify the credit not taken by these taxpayers, we selected only the returns where IRS processing determined that the taxpayer was eligible for the Child Tax Credit (CTC), but not all the CTC had been used to offset the taxpayer's tax liability, and the return contained the following three conditions: (1) the taxpayer did not claim the ACTC, (2) the taxpayer had sufficient earned income to qualify for the ACTC, and (3) the taxpayer showed a tax liability of zero.

¹ *Although the 2002 Filing Season Was Completed Timely, Customer Service Can Be Improved During Error Processing* (Reference Number 2002-40-200, dated September 2002).

² The IMF is the IRS database that maintains transactions or records of individual tax accounts.

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Appendix V

**Memorandum #1: Recommendation to Accelerate Outreach
to Taxpayers Who Did Not Receive the Additional Child Tax Credit for 2001**



INSPECTOR GENERAL
for TAX
ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

April 30, 2002

MEMORANDUM FOR DIRECTOR, SUBMISSION PROCESSING W:CAS:SP

FROM: DIRECTOR, IG:A:WIP:CAS

A handwritten signature in black ink, appearing to read "A. G. R. S.", written over the printed name "DIRECTOR, IG:A:WIP:CAS".

SUBJECT: Recommendation To Accelerate Outreach To Taxpayers Who
Did Not Receive The Additional Child Tax Credit For 2001

This recommendation is provided in response to our recent meeting on April 18, 2002. During this meeting you expressed a concern with the projected delay in receiving pertinent information needed for the IRS to proceed with an outreach program to identify and issue advisory notices to taxpayers entitled to possible tax credits under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). As discussed, we believe certain information gathered during our 2002 Filing Season Review could be used as a means for the IRS to effectively avoid this delay and accelerate its outreach program to a significant number of affected taxpayers immediately.

The EGTRRA included several new provisions for Tax Year (TY) 2001 that provide tax relief to lower-income working families. Among these provisions are modifications to the Child Tax Credit (CTC), a new 10 percent tax rate bracket, and a Rate Reduction Credit (RRC). Modifications to the CTC include increasing the credit amount to \$600 for each qualifying child and expanding the refundable provisions of the CTC to include taxpayers with less than three qualifying children. The refundable portion of CTC is known as Additional Child Tax Credit (ACTC) and is now refundable to the extent of 10 percent of the taxpayers earned income in excess of \$10,000. Under prior law, ACTC was limited to the Social Security and Medicare taxes paid by a taxpayer with three or more qualifying children.

The RRC provided immediate tax relief in 2001 by accelerating delivery of the new 10-percent tax rate bracket. Taxpayers received the credit in the form of a rebate check between July and December 2001. The amount of the credit was computed on the basis of tax returns filed for TY 2000 (instead of 2001). Taxpayers could receive a maximum credit of \$300 if single, \$500 if head-of-household, or \$600 if married filing jointly. If a taxpayer did not receive the maximum credit based on TY 2000 income,

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they may be entitled to additional credit based on the income reported on their TY 2001 return.

The Congress communicated to the Assistant Secretary (Tax Policy) Department of the Treasury on September 14, 2001, in part, the following: "Congress also intends that the refundable child credit provisions be fully effective in 2001. Consistent with this objective, for purposes of computing the rate reduction credit, taxpayers entitled to claim child credits should be given the maximum benefit of all refundable features of that credit. Thus, child credits that could be refundable under section 24(d) should be treated as refundable for purposes of determining the maximum credit available under section 6428(b)."

During the 2002 Filing Season, conditions occurred where lower-income taxpayers did not receive the full benefit of the ACTC and RRC. These conditions include:

- Taxpayers are not claiming ACTC under the new expanded provisions of the EGTRRA.
- Taxpayers did not claim the correct amount of the RRC they were entitled and the IRS adjusted the taxpayer's return to give them the benefit of the RRC but did not make subsequent adjustments to give them benefit of the refundable ACTC when the tax liability was zero.
- Taxpayers did not claim the correct amount of the RRC they were entitled and because of IRS return processing tolerances the taxpayer did not receive benefit of the credit.

Through Master File Cycle 14, 442,417 taxpayers have been identified that did not receive approximately \$164 million in Additional Child Tax Credits. The majority of these taxpayers have earned income of less than \$25,000 per year (76%) with most showing a filing status as unmarried head of household. Taxpayers that did not claim or receive the correct amount of the RRC because of return processing tolerances has not been determined. However, discussion with IRS management indicates that the number could be significant.

Before the 2002 Filing Season began, the IRS recognized that taxpayers might not claim the ACTC they are entitled under the new law. To address this condition, the IRS plans to notify taxpayers who appear eligible for the ACTC through advisory notices. These notices will be sent to taxpayers who did not claim and appear eligible for CTC and/or ACTC. Originally, the notices were to be sent beginning in July 2002. However, the Request for Information Services has not been finalized and the notices may not be sent until after September 2002. In addition, the IRS has indicated that it plans to address the condition where taxpayers did not receive their full RRC because of return processing tolerances. Since the RRC is applied against tax ahead of the CTC, the RRC condition must be considered before addressing CTC and ACTC in order to ensure that taxpayers receive the correct credits. Since the advisory notices for CTC

Outreach Initiatives Need to Ensure Taxpayers Receive the Benefit of the Child Tax and Additional Child Tax Credits

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and ACTC were planned before the RRC issue was identified, this unexpected complication could further delay issuing the notices.

To ensure that the refundable child tax credit provisions are fully effective for TY 2001 and taxpayers receive the benefit of the ACTC as soon as possible, we recommend that the IRS accelerate its outreach to taxpayers and issue advisory notices as quickly as possible. One method for accelerating taxpayer outreach could be to issue advisory notices to taxpayers identified by TIGTA during the 2002 Filing Season review. Since the beginning of the 2002 Filing Season, TIGTA has analyzed the IRS Return Transaction File to identify taxpayers that appear eligible for the ACTC. The information from this analysis could be used to begin issuing notices while the IRS prepares to identify other taxpayers who did not receive full benefit of the RRC and those that may be eligible for CTC.

If you have any questions, please call me at (972) 308-1670, or Audit Manager Gary Young at (512) 460-7074. We would appreciate a written response to this memorandum within 10 working days.

**Outreach Initiatives Need to Ensure Taxpayers Receive
the Benefit of the Child Tax and Additional Child Tax Credits**

Appendix VI

Management's Response to Memorandum #1



WAGE AND INVESTMENT DIVISION

**DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308**

JUL 03 2002

MEMORANDUM FOR DIRECTOR, IG:A:WIP:CAS

FROM:

Jimmy L. Smith 
Director, Submission Processing W:CAS:SP

SUBJECT:

Recommendation To Accelerate Outreach To Taxpayers Who
Did Not Receive The Additional Child Tax Credit For 2001

The following information is in response to your letter dated April 30, 2002, regarding the subject referenced above. An organizational decision has been made not to issue notices to taxpayers that do not claim the Child Tax Credit (CTC) and/or the Additional Child Tax Credit (ACTC) on their original tax return. There were several key issues considered in determining this difficult decision as described below.

The primary factor is the Service not having a statutory requirement to notify taxpayers about unclaimed/under-claimed statutory credits. Issuing the recommended advisory notices will result in the setting of a significant precedent. This precedent has the potential of obligating the Service to send notices to taxpayers potentially eligible for any statutory credit in order to prevent disparate treatment.

A secondary issue contributing to this decision is the resource impact. The cost to print and mail the notice and processing the subsequent replies is estimated to be approximately \$14.4 million. This includes a personnel cost equating to 300 staff years.

The final consideration is the impact of the computer programming required to issue the advisory notices. Any additional programming requests limit our ability to implement legislative changes and perform Systems Acceptability Testing (SAT) for tax year 2002 processing. Expending programming resources now for this initiative potentially reduces the Service's ability to respond to late legislation or other more critical needs.

We are exploring ways to create a better taxpayer awareness regarding this credit in the future. This includes contacting the Stakeholder Partnerships, Education and Communication (SPEC) and the Tax Form and Publications organizations for assistance in determining the most feasible and effective methods to reach these potentially eligible taxpayers.

If you have any questions or require any additional information, please call me at (859) 669-5552, or your staff may contact Bill R. Murphy at (202) 283-0361.

**Outreach Initiatives Need to Ensure Taxpayers Receive
the Benefit of the Child Tax and Additional Child Tax Credits**

Appendix VII

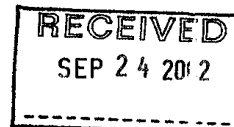
Management's Response to the Draft Report



WAGE AND INVESTMENT DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
ATLANTA, GA 30308

September 23, 2002



MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR TAX
ADMINISTRATION

FROM:

John M. Dalrymple
John M. Dalrymple
Commissioner, Wage and Investment Division

SUBJECT:

Draft Audit Report – Outreach Initiatives Need to Ensure
Taxpayers Receive the Benefit of the Child Tax and Additional
Child Tax Credits (Audit No. 200240057)

I appreciate your staff's efforts to help us reach a customer focused solution for taxpayers who may be eligible for the Child Tax Credit (CTC) and Additional Child Tax Credit (ACTC). We will advise the taxpayers you identified of their potential eligibility

Offering potentially eligible taxpayers an opportunity to correct their returns is a positive action, however we must continue our education efforts to minimize errors and omissions. Educating and informing our customers on their rights and entitlements helps them to file correct returns. It also reduces taxpayer burden, expedites the issuance of timely refunds, and is in the best interest of all taxpayers. This year we plan to further expand our efforts to ensure eligible taxpayers claim Child Tax and Additional Child Tax Credit. I have attached a brief summary that highlights some of the aggressive and targeted efforts the Stakeholder Partnerships, Education and Communication (SPEC) and its many partner organizations have taken to educate taxpayers about these tax credits. Attachment 2 is only a representative sample of these efforts. Unfortunately, you gave only marginal recognition of our efforts in your report.

Despite the effectiveness of our pre-filing effort some taxpayers will not claim the credit due to oversight or due to the complexity of the law. We support the Taxpayer Advocate's efforts to seek legislative remedies to ease the complexity of these issues. I am sure the Taxpayer Advocate would enjoy TIGTA's support as we collectively try to reduce taxpayer burden. The complexity of the law, programming difficulties, the legal requirements for claims and the availability of resources influenced our difficult decision not to pursue the outreach initiative.

Outreach Initiatives Need to Ensure Taxpayers Receive the Benefit of the Child Tax and Additional Child Tax Credits

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I am pleased our staffs worked together to find a viable alternative allowing us to advise the taxpayers identified in your review of their potential eligibility for the Additional Child Care Credit. Thank you for supporting our effort by providing a new computer extract with taxpayer information and addressees. We will mail special advisory information to the taxpayers identified as potentially eligible for the Additional Child Tax Credit and provide them needed tax forms and instructions on how to claim the credit if eligible.

I would also like to use our existing computer system more proactively when taxpayer errors, omissions or oversights appear to occur. Daily we deal with outdated systems that cannot support individualized return processes. Through our Modernization effort, we will overcome these limitations. For now, however, we must make programming and system related decisions based on the greatest common good for all taxpayers, not merely those who may have made an omission or oversight. We look forward to the time when we can more readily respond to such situations.

I cannot agree with Recommendation 2. Competing and compelling needs for computer programming and supporting resources exist at any time. As an organization, we must make difficult decisions based on priorities to implement changes to the tax laws and to support the Modernization effort. I commit to continuing to make recommendations and decisions on resource use based on providing equitable and balanced tax administration for our customers.

I agree with your computation of potential benefit in the outcome measure. The complexity of the legal requirements prevents anyone from accurately determining the eligibility of these taxpayers without direct verification.

If you have any questions, please call me or Ronald S. Rhodes, Director, Customer Account Services, at (404) 338-8910.

Attachments (2)

Outreach Initiatives Need to Ensure Taxpayers Receive the Benefit of the Child Tax and Additional Child Tax Credits

Attachment 1

RECOMMENDATION 1

The Commissioner, Wage and Investment (W&I), should consider modifying its 2002 outreach initiative to taxpayers by accelerating the issuance of advisory notices to ensure that taxpayers receive the tax benefit of the ACTC for the TY [Tax Year] 2001. Please see Appendix V for the additional details in the TIGTA memorandum issued April 30, 2002.

ASSESSMENT OF CAUSE

The IRS was unable to implement a plan to identify and notify taxpayers who were potentially eligible for ACTC for TY 2001.

CORRECTIVE ACTION

Although we cannot agree with this recommendation, through our cooperative efforts we will initiate a viable alternative to inform taxpayers of their potential eligibility. As a result of TIGTA's willingness to provide taxpayer address information, we will mail special advisory information to taxpayers identified as potentially eligible for the Additional Child Tax Credit and provide them tax forms and instructions on how to claim the credit if eligible.

IMPLEMENTATION DATE

Completion - December 31, 2002

RESPONSIBLE OFFICIALS

Director, Customer Account Service, W&I

Director, Submission Processing, W&I

RECOMMENDATION 2

The Commissioner, W&I, should reevaluate placing a higher priority to the discretionary computer programming necessary to implement future outreach initiatives based on the related tax laws that the initiatives are intended to support.

ASSESSMENT OF CAUSE

Due to high priority demands associated with implementing new tax law changes and other critical programming needs the IRS was not able to implement the Additional Child Tax Credit initiative.

CORRECTIVE ACTION

Not Applicable

**Outreach Initiatives Need to Ensure Taxpayers Receive
the Benefit of the Child Tax and Additional Child Tax Credits**

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IMPLEMENTATION DATE

Not Applicable

RESPONSIBLE OFFICIALS

Commissioner, Wage and Investment Division

Outreach Initiatives Need to Ensure Taxpayers Receive the Benefit of the Child Tax and Additional Child Tax Credits

Attachment 2

Child Tax Credit Initiatives

Stakeholder Partnerships, Education and Communication (SPEC) proactively leveraged its partnership relationships on local and national levels to educate taxpayers about the Child Tax Credit (CTC). Outreach for the CTC was a formal part of the FY02 Plan, and SPEC capitalized on the opportunity to tie it to the same audience as the Earned Income Tax Credit (EITC). SPEC "marketed" the CTC as a benefit to working families, and successfully convinced key stakeholders to assist with the outreach and education effort through newsletters, flyers, stuffers, posting information on bulletin boards, web sites, and tax preparation, etc. SPEC delivered education and awareness of the CTC to taxpayers across the country through leveraged partnerships with non-profit organizations, government organizations, community organizations, faith based organizations, employers, schools, financial institutions, and congressional offices. Below are representative examples:

- Columbus SPEC staff met with Columbus EITC/CTC Campaign champions at an Appreciation Breakfast sponsored by The Children's Defense Fund. Present were councilmen, civic leaders, and business representatives who have actively assured the EITC/CTC Awareness message has blanketed the Columbus area. The Columbus EITC/CTC Campaign has resulted in the distribution of 274,000 stuffers to water bill recipients, distribution of an additional 1,000 stuffers through Staffing Solutions (a temp agency), 10 billboards throughout the city, an EITC hotline message through the gas company, production of two local Public Service Announcements (PSA) for EITC, coordination with network affiliate stations and cable channels to run the PSA's, coordination with radio stations to run EITC PSA's, a press conference that included distribution of the Volunteer Income Tax Assistance/ Tax Counseling for the Elderly (VITA/TCE) site list, and production and distribution of locally designed EITC/CTC flyers.
- In Dayton, Ohio a press conference on January 29, 2002, at City Hall, announcing the Community Based Partnership. The press conference covered the EITC/CTC awareness campaign, an announcement about the HelpLink hotline (a specific number for EITC/CTC messages) and free tax preparation at VITA sites. The coalition produced a customized flyer that included the HelpLink number, EITC/CTC information, and a section about what to bring to a VITA site. The City of Dayton also included information about EITC/CTC on their Web Site. (<http://www.ci.dayton.oh.us/html/EITCintro.asp>)
- The Denver SPEC Staff attended the 2002 Colorado Works conference conducted on May 29-31 of this year. Over 600 Social Service Managers and employees from the State of Colorado attended the conference. The SPEC staff hosted an exhibit booth titled "Federal Tax Credits" where they distributed CTC:

Outreach Initiatives Need to Ensure Taxpayers Receive the Benefit of the Child Tax and Additional Child Tax Credits

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- publications and stuffers to conference participants. Included in the conference was a workshop presentation and panel discussion featuring SPEC's Denver coalition partners.
- During the week of March 25, 2002, Chicago Public Schools mailed 500,000 child tax credit stuffers to their students. Everyone on the mailing list has at least one child in school and the potential to claim the CTC, therefore the entire mailing reached the targeted audience.
- Baltimore/Washington, D.C. Territory presented EITC, CTC, and e-file to 61 staff members of the Baltimore Department of Social Services Central Childcare Office. These staff members have the potential to reach 7,000 low-income taxpayers.
- The Juvenile Welfare Board funds programs to better the lives of children and families in Pinellas County, Florida. To promote EITC and the CTC, we mailed over 5,000 letters to businesses, day care centers, houses of worship, and organizations that provide assistance to low-income residents. We provided take-home flyers to every child at each day care center educating the parents on EITC and CTC. The Board is adding a link from their web page to the IRS website.

Early in our planning, SPEC identified a need for new products to assist with education and awareness of the Child Tax Credit and produced three products:

1. Publication 3961, Child Tax Credit Stuffer in English
2. Publication 3911, Child Tax Credit Stuffer in English and Spanish
3. Publication 3965 Got Kids? Child Tax Credit Brochure

During FY 2002 SPEC produced over 1.5 million of these publications for distribution to targeted audiences through our partnerships and outreach efforts.